

# Michigan Business Tax Frequently Asked Questions

**NOTICE:** The MBT was amended by 145 PA 2007 on December 1, 2007. Act 145 imposes an annual surcharge to taxpayers' MBT liability, as well as makes other changes. The posted FAQs do not reflect these changes. Watch for revised FAQs and new FAQs that will discuss the impact of Act 145.

## Administrative

**Will taxpayers need to calculate the business income and modified gross receipts separately and pay 85% of each to meet the estimated tax payment safe harbor provision to avoid penalty and interest?**

Tax liability of the act is imposed on two components; federal taxable income derived from business activity and modified gross receipts. These two components form the basis for tax liability. Estimated tax payments are governed under Section 501. If the sum of the estimated payments equals at least 85% of the liability and the amount of each estimated payment reasonably approximates the tax liability incurred during the quarter for which the estimate is made, interest will not be assessed. Therefore, while a calculation must be made for each component in order to determine tax liability, only one estimated payment of 85% of that liability need be remitted. There is no requirement to remit an estimated payment for each separate tax liability component.

**When does the MBT take effect?**

The Michigan Business Tax is effective as of January 1, 2008. The MBT replaces the Single Business Tax which expires on December 31, 2007.

**Who must file MBT quarterly estimates?**

Taxpayers expecting an annual tax liability exceeding \$800 must file quarterly estimates.

**When are MBT quarterly estimates due?**

Quarterly returns and payments for calendar year filers are due April 15, July 15, October 15, and January 15. Quarterly returns and payments for fiscal year filers are due the 15th day of the first month after each quarter.

**How are quarterly estimates calculated?**

The sum of estimated payments must equal at least 85% of estimated tax liability for the year, and the amount of each estimated payment must reasonably approximate the tax liability for that quarter. For Tax Year 2009 and after, if prior year's tax is \$20,000 or less, estimated tax will be prior year's amount in four equal payments, the sum of which equals the previous year's tax liability. If the year's tax liability is \$800 or less, quarterly returns are not required.

**When are MBT Annual Returns due?**

Annual Returns are due the last day of the 4th month after tax year end with payment of final liability. Taxpayers (other than Insurance Companies or Financial Organizations) are not required to file or pay if apportioned gross receipts are less than \$350,000.

Filing threshold is annualized for tax year less than 12 months.

**How can I get an extension of time to file an MBT Annual Return?**

Taxpayers must file a Michigan Application for Extension of Time to File Michigan Tax Returns by the due date of the annual return with payment of estimated tax. Extensions will be granted by the Department for good cause.

If a federal extension is filed and granted, the Department will grant an automatic extension to the last day of the 8th month. Even if the IRS has approved a federal extension, a Michigan Application must also be filed.

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An extension of time to file is not an extension of time to pay. Payment must be included with the Application. Extension requests received without payment will not be honored and penalty and interest will accrue on the unpaid tax from the original due date of the return. If no tax will be due on the MBT annual return, there is no need to request an extension to avoid penalty and interest.

## **How is the tax computed if my first taxable year is less than 12 months?**

Tax is computed using one of the following methods:

- Annual Method: Report full year multiplied by a ratio of the number of months in the tax year included under the MBT divided by 12.
- Actual Method: Report only those months included under the MBT.

## **If I'm registered for the SBT what do I need to do to register for the MBT?**

You are automatically registered for the MBT if you are currently registered for the SBT.

## **When will forms be available for the Michigan Business Tax?**

We are on schedule to have the 2008 Michigan Business Tax forms and instructions available on the same schedule as the quarterly and annual returns for the other Michigan taxes.

Quarterly estimated Michigan Business Tax forms will be mailed to taxpayers starting in early January 2008 for payment of their Michigan Business Tax estimates.

When the legislature adjourns for the year in December 2008 the returns will be finalized, posted on our web site and sent to the printers. We anticipate the paper forms and instructions will be available for distribution to the public in January 2009.

Fiscal year taxpayers will be granted an automatic extension for their 2008 fiscal year annual return. Returns for fiscal years ending in 2008 will be due the same date as 2008 calendar year returns, which is April 30, 2009. An extension request form need not be filed unless required to transmit payment of any tax that would be due with the annual return. The annual return tax due must be paid by the original due date, which is the last day of the fourth month after the end of the fiscal year.

In addition Taxpayers will once again starting in February 2008 be able to pay their Michigan Business Tax estimate on their Combined Return for Michigan Taxes, (Form 160).

## **How does a Fiscal Year taxpayer file returns for their tax year ending in 2008?**

A taxpayer with a fiscal year beginning in 2007 and ending in 2008 must file two short period returns, one to report their final SBT liability, and the other to report their initial MBT liability.

Per Michigan Compiled Law (MCL) 208.151, the SBT is repealed on business activity in this state after December 31, 2007. A fiscal year SBT taxpayer must file a short year return for the period from the beginning of its 2007-2008 fiscal year through December 31, 2007.

A fiscal year MBT taxpayer must file a short year return for the period from January 1, 2008 to the ending of its 2007-08 fiscal year.

MCL 208.1503 provides for a computation of tax for the first tax year of less than 12 months. The SBTA does not address the computation of tax for the final tax year, however, the repeal language in MCL 208.152 requires the Department of Treasury to "prorate the liability for the tax imposed under the single business tax act as necessary to impose the equivalent of a tax at the rate of zero on business activity after December 31, 2007."

Consequently, a fiscal year taxpayer may elect to compute the tax for the final short period SBT year and the initial short period MBT year in accordance with 1 of the following methods:

1. Annual - The tax may be computed as if the Act(s) were effective throughout the taxpayer's 2007-08 federal tax period and the amount computed multiplied by a fraction,

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- the numerator of which is the number of months of the federal period that fall in 2007 or 2008, and the denominator of which is the number of months in the full federal period (typically 12).
2. Actual - The tax may be computed based on actual business activity occurring in the final/initial short period in accordance with an accounting method satisfactory to the department that reflects the actual business activity attributable to the period. The method of accounting used in prior fiscal years will be assumed to reflect the actual tax base attributable to the period.

The method the taxpayer employs for its final SBT return must also be used for the initial MBT return. Thus, if a taxpayer elects to use the annual method for its final SBT return it must also use the annual method for its initial MBT return.

## **Will there be E services with MBT?**

The Department is working on the implementation of electronic filing for MBT returns and plans to have this service available when the initial 2008 calendar years returns become due in April of 2009.

## **Will a safe harbor be allowed for 2008 estimates based on the 2007 SBT return?**

No. For the 2008 tax year, estimated MBT payments must be computed on the actual business income tax base and modified gross receipts tax base of the period combined. Safe harbor will apply, and no interest will be charged, if payments are made on time and the sum of the estimated payments equals at least 85% of annual liability, and the amount of each payment reasonably approximates the tax liability incurred during the period. Estimates cannot be based on the prior year's SBT liability and cannot be based on 1% of gross receipts.

For the 2009 and subsequent tax years, no interest will be charged if the sum of four estimated payments equals the previous year's MBT liability provided the previous year's liability was \$20,000 or less and the payments were made equally over the year.

## **Will the business income tax and modified gross receipts tax be filed on a single return or on separate returns?**

For taxpayers other than insurance companies and financial institutions, there will be a single MBT return that includes both the business income and modified gross receipts taxes. There may be multiple schedules.

## **May a taxpayer make estimated MBT payments on Form 160, the Combined Return for Michigan Taxes, and if so, how will the different due dates be reconciled?**

For a calendar year taxpayer, MBT quarterly returns are due the 15<sup>th</sup> day of April, July, October and January. For fiscal year filers, quarterly returns are due the 15<sup>th</sup> day of the first month after each quarter. MBT payments may be made with either of the following returns:

- Form 4548, *Michigan Business Tax Quarterly Return*, or
- Form 160, *Combined Return for Michigan Taxes*.

If filing monthly using Form 160, *Combined Return for Michigan Taxes*, and not making remittances by electronic funds transfer, monthly payments may be filed on the 20th day of the month. For example, a calendar year taxpayer may file monthly MBT estimates using Form 160 on February 20<sup>th</sup>, March 20<sup>th</sup> and on April 20<sup>th</sup> rather than April 15 for the first quarter. However, for taxpayers required to make remittances by electronic funds transfer or otherwise not using Form 160, MBT estimates remain due on the 15<sup>th</sup> day of the month following the final month of the quarter. Regardless of the method chosen, the estimated MBT for the quarter must also reasonably approximate the liability for the quarter.

## **Will an estimated return be due for a taxpayer with a short taxable year of less than four months under the MBT?**

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No. An estimated return is not required for a fiscal year filer with a short taxable year of less than four calendar months under the MBT. This is similar to the treatment under IRS regulation 1.6655-5.

Payment of the annual tax liability remains due on the last day of the fourth month after the end of the fiscal year. Returns for fiscal years ending in 2008 will automatically be extended to be due the same date as 2008 calendar year returns, April 30, 2009.

For example, for a fiscal year taxpayer with a January 31, 2008 year end, an estimate would normally be due on February 15, 2008. However, this taxpayer has a short taxable year of less than four months and is not required to make an estimated return or payment. The taxpayer must pay its annual liability on May 31, 2008 but its annual return will be extended until April 30, 2009.

## **What is the filing threshold under the Michigan Business Tax Act (MBTA)?**

Section 505(1) (MCL 208.1505(1)) of the MBTA directs that a taxpayer, *other than* an insurance company or financial institution, whose apportioned or allocated gross receipts are less than \$350,000.00, does not need to file a return or pay the tax imposed under the MBTA.

An insurance company, regulated by chapter 2A of the MBTA, does not have a filing threshold regarding its liability to pay the tax on gross direct premiums written on Michigan property or risk. Likewise, a financial institution, regulated by chapter 2B of the MBTA, does not have a filing threshold regarding its liability to pay the franchise tax on its net capital.

## **Will SBT overpayments be applied to MBT?**

Yes. At the option of the taxpayer, any SBT overpayments from the final return may be either refunded or carried forward and applied to the initial MBT return. For fiscal year filers, the final SBT return must be made on a short year return filed for the period ending on December 31, 2007. The due date of the final SBT short year return will be April 30, 2008. If payment of the estimated tax due is made on or before this due date with an extension request, an extension of time to file the short year return will automatically be granted until the standard fiscal year due date.

## **When are the first and second estimated MBT payments due for a fiscal year filer with an April 30, 2008 year end?**

Section 501(2) of the MBTA (MCL 208.1501(2)) instructs that, "Taxpayers not on a calendar year basis shall file quarterly returns and make estimated payments on the appropriate due date which in the taxpayer's fiscal year corresponds to the calendar year."

The taxpayer in this question has a fiscal year that runs from May 1, 2007 through April 30, 2008. The Single Business Tax Act (SBTA) would apply to the taxpayer's business activity from May 1, 2007 through December 31, 2007. Under the SBTA, the taxpayer's quarterly estimated payments are due on August 31 and November 30. Based upon the prior fiscal year end, the taxpayer's first quarterly estimated payment of MBT is due on February 15, 2008, and the second on May 15, 2008.

## **Can a fiscal year filer request an extension for the first MBT return?**

Fiscal year taxpayers will be granted an automatic extension for their 2008 fiscal year annual return. Returns for fiscal years ending in 2008 will be due the same date as 2008 calendar year returns, which is April 30, 2009. However, an extension of time to file is not an extension of time to pay. An extension request form need not be filed unless required to transmit payment of any tax that would be due with the annual return. The annual return tax due must be paid by the original due date, which is the last day of the fourth month after the end of the fiscal year.

A fiscal year taxpayer may request an additional extension on Form 4, *Application for Extension of Time to File Michigan Tax Returns*, if the extension to April 30, 2009 is not sufficient, e.g., a

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taxpayer with a fiscal year ending November 2008, with a federal extension granted through September 2009.

## **How does a taxpayer with a fiscal year end calculate tax under the MBT for estimate purposes?**

If estimated tax liability for the year is over \$800.00, a taxpayer must file estimated quarterly returns and payments. Quarterly returns for fiscal year taxpayers are due the 15<sup>th</sup> day of the first month after each quarter. Any quarter less than 3 months is due on the 15<sup>th</sup> day of the month immediately following the final month of the taxpayer's tax year. In the case of a short taxable year, no estimated tax payment is required if the short taxable year is a period of less than four full calendar months; or the estimated tax liability for the year is \$800.00 or less. See IRS Reg. 1.6655-5(b).

The estimated payment made with each quarterly return must be for the total estimated business income tax base and modified gross receipts tax base for the quarter, or 25% of the estimated annual liability. To avoid penalty and interest charges, estimated payments must equal at least 85 percent of the liability for the tax year, and the amount of each estimated payment must reasonably approximate the tax liability for each quarter. If the year's tax liability is \$800.00 or less, quarterly returns are not required. Estimates cannot be based on the prior year's SBT liability, and can no longer be based on 1% of gross receipts.

For taxpayer's whose apportioned or allocated gross receipts equal \$350,000 or more, the MBTA imposes a 4.95% business income tax and a modified gross receipts tax at the rate of 0.8%. A credit reduces the tax correspondingly if gross receipts are between \$350,000 and \$700,000.

For most taxpayers, the business income tax base is essentially that part of federal taxable income derived from business activity, modified by the following to the extent included in, excluded from, or deducted in arriving at federal taxable income:

### Additions:

- Interest income and dividends derived from obligations or securities of states other than Michigan,
- Taxes on or measured by net income and the tax imposed under the MBT,
- Any carryback or carryover of a net operating loss,
- Loss attributable to another taxable entity,
- Royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset if the person is not included in the taxpayer's unitary business group.

### Subtract:

- Dividends and royalties received from persons other than United States persons and foreign operating entities,
- Income attributable to another taxable entity,
- Interest income derived from United States obligations,
- Earnings that are net earnings from self-employment as defined under section 1402 of the internal revenue code of the taxpayer or a partner or limited liability company member of the taxpayer except to the extent that those net earnings represent a reasonable return on capital.

The modified gross receipts tax base consists of gross receipts less purchases from other firms. Gross receipts are defined as the entire amount received by a taxpayer from any activity carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others, with certain

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specific exceptions. "Purchases from other firms" is generally limited to inventory acquired during the tax year, depreciable assets acquired during the tax year, and materials and supplies directly connected to inventory on depreciable assets.

## Unitary

### **How does a unitary business group apportion its tax bases when some members of the group do not have nexus with Michigan?**

For a unitary group with business activities within and without Michigan, as defined in MCL 208.1301(3), the tax bases are apportioned to this state by multiplying them by the sales factor. The tax bases of a unitary group are calculated according to MCL 208.1201 and 208.1203. The sales factor is Michigan sales divided by everywhere sales. The sales of all members of the unitary group are included in both the numerator and the denominator.

### **An out-of-state Real Estate Investment Trust (REIT) has a Michigan subsidiary. The Michigan subsidiary was previously required to file SBT returns. The REIT did not file SBT returns. A single federal return is filed for the REIT and its subsidiary. Under the MBT, can the subsidiary continue to file separately or will the REIT and subsidiary be required to file a consolidated return?**

To the extent these entities meet the definition of a "unitary business group" the group is deemed the taxpayer and a combined tax return must be filed. MCL 208.117(5).

Under MCL 208.117(6), a "unitary business group" includes a group of businesses, 1 of which owns or controls more than 50% of the ownership interest, and that has business activities or operations which result in a flow of value between or among persons in the group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. When at least one member of a unitary group has substantial nexus with Michigan, as defined by MCL 208.1200, all Michigan sales by members of the unitary group are included in the numerator of the apportionment factor.

### **How does a unitary business group apportion its tax bases under the MBT? Is the apportioned tax base of a unitary group allocated back to the members of the unitary business group?**

The business income tax base and modified gross receipts tax base of "a taxpayer whose business activities are subject to tax both within and outside of this state shall be apportioned to this state" by multiplying the business income tax base and modified gross receipts tax base by the sales factor. MCL 208.1301 (emphasis added). The sales factor is a fraction, "the numerator of which is the total sales of the taxpayer in this state during the tax year and the denominator of which is the total sales of the taxpayer everywhere during the tax year." MCL 208.1303(1). Sales are sourced to Michigan or elsewhere under MCL 208.1305.

"Taxpayer" means "a person or a unitary business group liable for a tax, interest, or under this act." MCL 208.1117 (emphasis added). In other words, apportionment is not calculated separately for each member of the unitary business group but on the combined tax bases as calculated under MCL 208.1201 and 208.1203. There is no need to allocate the apportioned tax base of the unitary business group back to the members of the unitary business group.

### **What is a unitary business group?**

Generally, a unitary business group is a group of related persons – including entities – whose business activities or operations are interdependent. More specifically, a unitary business group is two or more persons that satisfy both a *control test* and one of two *relationship tests*. MCL 208.1117(6). A unitary business group is a single taxpayer under the MBT and must file a combined return. MCL 208.1117(5), 208.1511. Foreign persons and foreign operating entities cannot be part of a unitary business group.

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**Control Test.** The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other person or persons. Generally, indirect ownership is determined using IRC 318, except that the Department will apply IRC 318 to all forms of ownership interests.

**Relationship Tests.** In addition to satisfying the control test, the group of persons must have business activities or operations that (1) result in a *flow of value* between or among persons in the group, or (2) are *integrated with, are dependent upon, or contribute to each other*.

*Flow of value* is established when members of the group demonstrate one or more of functional integration, centralized management, and economies of scale. Examples of functional integration include common programs or systems and shared information or property. Examples of centralized management include common management or directors, shared staff functions, and business decisions made for the group rather than separately by each member. Examples of economies of scale include centralized business functions and pooled benefits or insurance. Groups that commonly exhibit a flow of value include vertically or horizontally integrated businesses, conglomerates, parent companies with their wholly owned subsidiaries, and entities in the same general line of business. Flow of value must be more than the mere flow of funds arising out of passive investment.

Businesses are *integrated with, are dependent upon, or contribute to each other* under many of the same circumstances that establish flow of value. However, this alternate relationship test is also commonly satisfied when one entity finances the operations of another or when there exist intercompany transactions, including financing.

**Can brother-sister corporations wholly owned by a single individual be members of a unitary business group? What if the corporations conduct no interrelated business activities?**

Under the MBT, a unitary business group is:

a group of United States persons, other than a foreign operating entity, 1 of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights to voting rights of the other United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

The Department will follow IRC § 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the Department will apply IRC § 318 to all ownership interests regardless of entity type.

Thus, to qualify as a unitary business group under the MBT, a group must satisfy the *control test* and one of two *relationship tests*: business activities or operations that (1) result in a *flow of value* between members or that (2) are *integrated with, dependent upon, or contribute to each other*.

In the case of a brother-sister set of corporations wholly owned by an individual – for example, Motorcycle Dealer Co. and Architecture Inc. – the corporations will satisfy the control test under MCL 208.1117. Under IRC § 318(a)(3)(C), Motorcycle Dealer Co. is the indirect owner of more than 50% of the ownership interests in Architecture Inc. However, the brother-sister corporations will not comprise a unitary business group unless the corporations also satisfy one of the two relationship tests.

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To the extent that Motorcycle Dealer Co. and Architecture Inc. have business activities or operations that result in a flow of value between them or have business activities or operations that are integrated with, are dependent upon, or contribute to each other, the corporations will comprise a unitary business group. Whether such relationship tests are met must be determined on a facts and circumstances basis. The fact that there are no interrelated business activities between the corporations is not dispositive. For example, centralized management; shared systems, programs, or benefits; or using the proceeds from one corporation to finance the activities of the other will satisfy the relationship test regardless of the absence of business activities conducted between the brother and sister.

## **If a husband and wife are 100% owners in different businesses; do they form a unitary group?**

Under MCL 208.1117(6), a unitary business group is defined – in part – as a group of U.S. persons, excluding foreign operating entities, one of which owns or controls, directly or indirectly, more than 50% of the ownership interests with voting or similar rights of the other U.S. persons and the business activities or operations result in a flow of value between the unitary group or are integrated with, dependent upon or contribute to each other. The “more than 50%” ownership for purposes of defining a unitary business group includes direct and indirect ownership.

For purposes of MCL 208.1117(6), the Department will follow IRC § 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the Department will apply IRC § 318 to all ownership interests. For example, while IRC § 318 specifically governs constructive ownership of “stock,” the Department will apply IRC § 318 to ownership interests in partnerships, limited liability companies, and other U.S. persons under the MBT. A spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance) is deemed to own the ownership interest of the other and vice versa.

Under these facts and circumstances the more than 50% ownership interest is met as each taxpayer business is deemed to own 100% of the other. If there is a flow of value between the business entities owned by the husband and wife or they are integrated with, dependent upon or contribute to each other, a unitary group will exist. A flow of value is determined by reviewing the totality of facts and circumstances of the business activities and operations.

## **Are special purpose entities taxpayers under the MBT?**

Yes. Under the MBT, taxpayer means “a person or a unitary business group liable for a tax, interest, or penalty.” MCL 208.1117(5). “Person” means “an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit.” MCL 208.1113(3).

According to Black's Law Dictionary, “special purpose entity” is defined as “a business established to perform no function other than to develop, own, and operate a large complex project . . . .” Black's Law Dictionary (7th ed). More generally, a special purpose entity can be defined as a business formed solely in order to fulfill narrow, specific or temporary objectives. Special purpose entities are often used to facilitate securitization.

Thus, to the extent that it satisfies the filing threshold, a special purpose entity will be a taxpayer under the MBT. Alternatively, a special purpose entity may be a member of a unitary business group if the control test and one of the two relationship tests of MCL 208.1117(6) are satisfied. There are no exemptions under the MBT for special purpose entities.

## **How are the business income and modified gross receipts tax bases apportioned for a unitary business group that includes both transportation companies and companies other than transportation companies?**



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The business income tax base and modified gross receipts tax base of a taxpayer whose business activities are subject to tax within and without Michigan must be apportioned by multiplying each tax base by the sales factor. MCL 208.1301(1). Taxpayer includes a unitary business group. MCL 208.1117(5).

The sales factor is a fraction of Michigan sales over sales everywhere. MCL 208.1303(1). For a unitary business group, the Michigan sales of each member – without regard to nexus – are combined in the numerator and all sales of each member are combined in the denominator. MCL 208.1303(2). Sales between members of a unitary group are eliminated when calculating the sales factor. MCL 208.1303(2), 208.1511.

Sales are sourced to Michigan and elsewhere under MCL 208.1305. Receipts from transportation services provided by a transportation company or any other company are sourced according to MCL 208.1305(11), (12). Receipts from transportation services are then combined with other receipts or sales of that member and those of other members of the unitary business group in the numerator and denominator to compute the sales factor. Although transportation services are subject to a specific sourcing rule, transportation companies do not – and receipts from transportation services are not – apportioned separately.

## **Are unitary business groups under the MBT the same as controlled groups under the SBT?**

No. Under the MBT, a unitary business group is:

a group of United States persons, other than a foreign operating entity, 1 of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights to voting rights of the other United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

The Department will follow IRC § 318 pertaining to constructive ownership of corporate stock, or analogous authority to determine indirect, or constructive ownership and control. However, the Department will apply IRC § 318 principles to ownership interests for all types of entities subject to the MBT.

To qualify as a unitary business group under the MBT, a group must satisfy the *control test* and one of two *relationship tests*: business activities that (1) result in a *flow of value* between members; or that (2) are *integrated with, dependent upon, or contribute to* each other.

In contrast, "controlled groups" under the SBT are generally defined as:

[a]n affiliated group as defined in this act, a controlled group of corporations as defined in section 1563 of the internal revenue code and further described in 26 C.F.R. 1.414(b)-1 and 1.414(c)-1 to 1.414(c)-5, or an entity under common control as defined by the internal revenue code . . . . [See MCL 208.36.]

An "affiliated group" means "2 or United States corporations, 1 of which owns or controls, directly or indirectly, 80% or more of the capital stock with voting rights of the other United States corporation or United States corporations." MCL 208.3. Under IRC 1563, control of a brother-sister controlled group is established if five or fewer persons combine to possess more than 50% of the stock of each corporation. RAB 1989-48 concludes – in part – that entities under common control exist when five or fewer persons combine to own a controlling interest in each entity.

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In other words, the ownership tests for controlled groups under the SBT differ from that under the MBT. The MBT requires members of a unitary business group to meet a relationship test not found in the SBT. Therefore, while there might be some overlap between affiliated groups under the SBT and unitary business groups under the MBT, an affiliated group under the SBT will not necessarily be a unitary business group under the MBT. All facts and circumstances related to business activities and operations should be reviewed when determining whether a unitary group exists and who the members of the group are.

## **Would a group of companies who have a flow of value between them but are owned by two nonrelated persons, each owning 50%, be considered a unitary business group?**

No. To meet the definition of a unitary business group in the Michigan Business Tax Act (MBTA) the U.S. persons, other than foreign operating entities, which cannot be included in the group, must pass a control test and 1 of 2 relationship tests. MCL 208.1117(6). The control test requires that one of the U.S. persons own or control, directly or indirectly, *more than 50%* of the ownership interests with voting rights or similar rights of the other U.S. persons. MCL 208.1117(6).

For purposes of MBTA section 117(6), the Department will use as guidance attribution rules expressed in IRC § 318 or analogous authority to determine indirect or constructive ownership and control. While IRC § 318 specifically pertains to corporate stock ownership, the Department will apply its principles to all forms of entities subject to the MBT.

As the subject persons are described as nonrelated and each owning 50% of the group, the control test in section 117(6) is not met. Thus, these entities do not comprise a unitary business group.

## **Apportionment**

**Under Chapter 3 of the MBT, if the business activities of a taxpayer are subject to tax within and without the state, each tax base must be apportioned based on the formula of sales in Michigan over sales everywhere. For purposes of apportionment, "sale" is defined in part as:**

**[t]he transfer of title to, or possession of, property that is stock in trade or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. [MCL 208.1115(1).]**

## **Is the occasional sale of assets by a taxpayer a "sale" for apportionment purposes?**

No, so long as the assets sold are neither stock in trade nor inventory and are not held by the taxpayer for sale to customers in the ordinary course of the taxpayer's business. This determination is made on a facts and circumstances basis. For example, the occasional and isolated sale of a desk by a law firm is not a "sale" under MCL 208.1115; the desk does not constitute stock in trade or inventory to the law firm and is not held by the taxpayer primarily for sale to customers in the ordinary course of the law firm's business. In contrast, if the law firm operates a program under which office furniture is routinely and systematically sold at auction, then such sales would be "sales" under MCL 208.1115.

If a transaction is not a "sale" under MCL 208.1115, it will be excluded from both the numerator and denominator of the sales factor.

"Sales" under MCL 208.1115 may still be included in the business income and modified gross receipts tax bases.

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## **Does the Michigan Business Tax Act (MBTA) provide for “throw back sales”?**

The MBTA does not provide for “throw back sales.” A “throw back sale” describes a situation in which the income or activity from a Michigan taxpayer’s sale of tangible personal property to an out-of-state purchaser is not taxable in the state of the purchaser. The sale would then be “thrown back” to Michigan by inclusion in the sales apportionment factor’s numerator, and increase the portion of the tax base subject to the Michigan Business Tax.

Sales to destinations outside Michigan need not be included in the MBT sales factor numerator regardless of whether nexus exists or tax is paid in the destination jurisdiction. However, if the taxpayer does not have nexus in at least one other state, they cannot apportion their tax base, and all business income, modified gross receipts and net capital tax bases are fully allocated to Michigan. The direct premiums tax base for insurance companies is not subject to apportionment.

## **Nexus**

### **How does a unitary business group apportion its tax bases when some members of the group do not have nexus with Michigan?**

For a unitary group with business activities within and without Michigan, as defined in MCL 208.1301(3), the tax bases are apportioned to this state by multiplying them by the sales factor. The tax bases of a unitary group are calculated according to MCL 208.1201 and 208.1203. The sales factor is Michigan sales divided by everywhere sales. The sales of all members of the unitary group are included in both the numerator and the denominator.

### **What are the nexus standards under the MBT?**

A taxpayer, other than an insurance company, has nexus with Michigan and is subject to the tax imposed under the MBT if (a) the taxpayer has a physical presence in this state for more than one day in a tax year, or (b) the taxpayer actively solicits sales in this state and has unapportioned gross receipts of \$350,000 or more sourced to this state. MCL 208.1200(1).

However, the business income tax is limited by federal statutory provisions commonly referred to as PL 86-272, which prohibits Michigan from imposing the tax if the only in-state business activity of the out-of-state person is the solicitation of orders for sales of tangible personal property where the orders are sent outside the state for approval or rejection and are filled by shipment or delivery from a point outside the state. 15 USC 381 et seq. Once a taxpayer exceeds the safe harbor of PL 86-272, the taxpayer is then subject to the business income tax on its entire tax base, including that portion of income otherwise protected by PL 86 272.

Physical presence means "any activity conducted by the taxpayer or on behalf of the taxpayer by the taxpayer's employee, agent, or independent contractor acting in a representative capacity." MCL 208.1201(3). Physical presence does not include "the activities of professionals providing services in a professional capacity or other service providers if the activity is not significantly associated with the taxpayer's ability to establish and maintain a market in this state." MCL 208.1201(3). [Although RAB's issued under the SBT are limited to the SBT, future guidance regarding physical presence under the MBT will likely be similar to that found in RAB 1998-1.]

The "actively solicits" provision will be further defined by the Department prior to January 1, 2008.

Insurance companies are subject to the MBT on all property or risk located or residing in this state. MCL 208.1235.

## **Business Income Tax**

# Michigan Business Tax Frequently Asked Questions

**Will shareholders of S corporations and partners in partnerships be liable for Michigan individual income tax on their share of flow-through income from entities subject to MBT? Does it matter whether the shareholders or partners are residents or nonresidents?**

Both residents and nonresidents of Michigan are subject to Michigan income tax on their share of income from partnerships and S corporations to the extent the income is attributable to Michigan under the allocation and apportionment provisions of the Michigan Income Tax Act (MCL 206.111 - 115) and included in adjusted gross income on the partner or shareholder's federal income tax return. The imposition of the Michigan business income tax on a flow through entity under section 201 of the Michigan Business Tax Act does not affect the imposition of the Michigan income tax under section 51 of the Michigan income tax act (MCL 206.51) on the individual partners or shareholders of the flow through entity.

**Under MCL 208.1201, the business income tax base means the business income of the taxpayer subject to certain adjustments, including a deduction for net earnings from self-employment. Specifically, the section instructs "[t]o the extent included in federal taxable income, deduct any earnings that are net earnings from self-employment as defined under section 1402 of the [IRC] of the taxpayer or a partner or limited liability company member of the taxpayer except to the extent that those net earnings represent a reasonable return on capital." MCL 208.1201(2)(h). What impact does this deduction have on the business income tax base of professional service partnerships (for example, some consulting, law, and accounting firms)?**

The impact of any deduction from business income to calculate the tax base varies by taxpayer. However, net earnings from self-employment under IRC 1402 generally means "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in [IRC] 702(a)(8) from any trade or business carried on by a partnership of which he is a member," subject to certain exclusions, including rentals from real estate, dividends and interest, and certain net operating losses and personal exemptions. IRC 1402(a). Therefore, the deduction from business income for net earnings from self-employment for some professional service partnerships is likely to result in a significantly reduced business income tax base.

**Corporations, Limited Liability Companies (LLCs), and Partnerships will be able to fully deduct amounts paid out as compensation to employees, as well as a 100% deduction for distributions that are subject to self employment income tax. Are S corporations treated in the same manner as partnerships and corporations in this regard? Can you clarify the treatment of S corporation distributions?**

The starting point for the calculation of the income tax component of the MBT is business income, defined generally as "that part of federal taxable income derived from business activity." MCL 208.1105(2). Corporations, including S corporations, LLCs, partnerships, sole proprietorships, and any other business entity subject to MBT may deduct all compensation paid to employees to the full extent deducted in arriving at federal taxable income when computing the MBT income tax base under MCL 208.1201.

MCL 208.1201 provides for a series of specific adjustments that must be made to business income to arrive at the business income tax base. One of these adjustments is a deduction for self employment income as defined in section 1402 of the Internal Revenue Code. MCL 208.1201(2)(h). Under section 1402, the business income of an individual or sole proprietor, and a partner's distributive share of partnership income, whether distributed or not, from any trade or business carried on by the partnership, may be considered self employment income (with certain statutory exceptions), and subject to the federal self employment tax. Therefore, a sole proprietorship or partnership may deduct any income subject to the federal self employment tax when computing the MBT income tax base. Corporations, including S corporations, are not subject to self employment tax, and, as a result, no deduction is allowed for earnings from self employment income for corporate entities. There is no deduction allowed for S corporation

# Michigan Business Tax Frequently Asked Questions

distributions that is equivalent to the self employment deduction allowed for partnerships and sole proprietorships under the MBT.

## **Are capital gains that are included in the Modified Gross Receipts tax base also included in the Business Income tax base?**

Yes, the Business Income tax base is a separate and distinct tax base from the Modified Gross Receipts tax base. A taxpayer's Business Income tax base is its business income subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is defined in part as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, . . . , made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, . . . ." MCL 208.1105(1).

MCL 208.1201 of the MBT makes no provision for the adjustment of capital gains that may be included in federal taxable income derived from business activity. As a result, to the extent the capital gain is derived from the business activity of the taxpayer it must also be included in the business income tax base.

## **Is the deduction provided under MCL 208.1201(2)(i) altered by the MBT surcharge?**

No. The deduction provided in section 201(2)(i) functions to offset the book-to-tax difference or deferred tax liability resulting from the change from the SBT to the MBT. The credit is taken in defined percentages beginning in tax year 2015. MCL 208.1201(2)(1).

MCL 208.1201(3) states that the deduction is only available in "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. The amount of the deferred tax liability and the corresponding deduction will be calculated without reference to the surcharge, and the deduction will therefore remain the same as calculated prior to the enactment of 2007 PA 145.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

## **Does the deduction provided under MCL 208.1201(2)(i) reduce the MBT surcharge imposed under MCL 208.1281(1)?**

Yes. MCL 208.1201(3) directs that the deduction "is intended to flow through and reduce the surcharge imposed and levied under section 281." (Emphasis added). This same section explains that the deduction is calculated as the "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. MCL 208.1201(3). The surcharge is calculated against a "taxpayer's liability under [the MBT] after allocation or apportionment to this state under this act but before calculation of the various credits." The surcharge is, thus, calculated against a taxpayer's business income and gross receipt liabilities. Therefore, the deduction, which reduces the business income tax base upon which the surcharge is calculated, will flow through and reduce the surcharge.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

# Michigan Business Tax Frequently Asked Questions

## Modified Gross Receipts

### **Does the Modified Gross Receipts Tax component of the Michigan Business Tax Act tax capital gains of investors, including trusts, Family Limited Partnerships and individuals?**

Yes, the modified gross receipts tax is a tax on every taxpayer with nexus. "Taxpayer" means a person or a unitary business group liable for a tax, interest, or penalty under this act. The term "person" means an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit. Therefore, the modified gross receipts tax is imposed on the above named persons if taxpayer nexus with Michigan exists.

The modified gross receipts tax base is a taxpayer's gross receipts less purchases from other firms before apportionment. The definition of "gross receipts" means the entire amount received by the taxpayer from any activity whether intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others with certain exceptions. MCL 208.1111(1)(o) excepts from gross receipts, proceeds from sales of capital assets as defined in section 1221(a) of the internal revenue code, less any gain from the disposition to the extent that gain is included in federal taxable income. Stated another way, the gain included in federal taxable income is included in the modified gross receipts tax base. There are no other statutory exceptions or exclusions that are applicable to capital gains recognized from the sale of investment assets. As a result, these gains are included in gross receipts.

### **How are gross receipts, rents etc. received from real property apportioned?**

Receipts from real property are apportioned based on location of the real property.

Rental income received from real property is included in both the business income from business activity tax base and modified gross receipts tax base of the taxpayer. Business activity includes the rental of property. MCL 208.1105(1).

Under MCL 205.1301(1) each tax base is apportioned or allocated in accordance with the rules under Chapter 3 of the Act. Sales confined solely to Michigan are allocated to Michigan. Sales within and outside of Michigan are apportioned based on a sales factor calculated under section 303. MCL 208.1301(2).

The sales factor is a fraction, the numerator is Michigan sales and the denominator is sales everywhere. MCL 208.1303(1). Receipts from the sale, lease, rental or licensing of real property are Michigan sales if the property is located in Michigan. MCL 208.1305(1)(b).

### **Is rental income included in gross receipts?**

Yes. The Michigan Business Tax Act (MBTA) defines "gross receipts" as, "[t]he entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others." [MCL 208.1111(1)] Section 111(1) of the MBTA contains specified exceptions to the definition of "gross receipts" but rental income is not listed among the exceptions.

### **The modified gross receipts tax base means the gross receipts of the taxpayer less "purchases from other firms." The definition of "purchases from other firms" includes "materials and supplies" to the extent not included in inventory and assets as defined. What, specifically, is the definition of "materials and supplies"?**

Under MCL 208.1113(6), "purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

# Michigan Business Tax Frequently Asked Questions

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

As used in MCL 208.1113(6)(c), "materials and supplies" means tangible personal property acquired during the tax year to be used or consumed in – and directly connected to – the production or management of inventory under MCL 208.1113(6)(a) or the operation or maintenance of assets under MCL 208.1113(6)(b). "Materials and supplies" includes repair parts and fuel.

## **Will a Single Business Tax (SBT) business loss carry forward carry over to the Michigan Business Tax (MBT)? Is the deduction before or after apportionment?**

The MBT provides for a limited deduction of SBT business loss carry forward in the 2008 MBT tax year in calculating the Modified Gross Receipts tax base only. MCL 208.1203(4) provides that 65% of any SBT business loss carry forward that was actually incurred in the 2006 or 2007 SBT tax years and that was not previously deducted in tax years beginning before January 1, 2008 may be deducted against the Modified Gross Receipts tax base. Any business loss carry forward incurred before January 1, 2006 is not eligible for the deduction.

If the taxpayer is a unitary business group, the business loss carry forward may only be deducted against the Modified Gross Receipts tax base of the person included in the unitary business group that generated the loss.

The deduction for the business loss carry forward is taken against the Modified Gross Receipts tax base after apportionment.

## **Is labor deductible from gross receipts as a "purchase from other firms?"**

Generally, no. Under MCL 208.1113(6), "purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

(d) For a staffing company, compensation of personnel supplied to customers of staffing companies.

\* \* \*

(e) For a person included in major groups 15, 16, and 17 under the standard industrial classification code as compiled by the United States department of labor that does not qualify for a credit under section 417, payments to subcontractors for a construction project under a contract specific to that project.

That is, for taxpayers other than staffing companies and contractors (persons included in SIC codes 15, 16, and 17), labor is not included in "purchases from other firms." For staffing companies, labor may be deductible to the extent that it constitutes compensation of personnel supplied to its customers. For contractors, labor may be deductible to the extent that it is included in payments made to subcontractors under a contract specific to a project.

# Michigan Business Tax Frequently Asked Questions

**Do shipping and delivery charges not included in the contract price for inventory constitute "purchases from other firms?" For example, are shipping charges paid to a third party to deliver inventory purchased from a vendor deductible from gross receipts?**

No. Under MCL 208.1113(6), "purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

\* \* \*

(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

In other words, "purchases from other firms" includes shipping and delivery charges related to inventory only when such charges are "included in the original contract price for that inventory." MCL 208.1113(6). Furthermore, shipping and delivery charges are not included in "materials and supplies."

**Are amounts paid by a taxpayer to a staffing company deductible from gross receipts as "purchases from other firms?"**

No. Under MCL 208.1113(6), "purchases from other firms" includes:

(d) For a staffing company, compensation of personnel supplied to customers of staffing companies. As used in this subdivision:

(i) "Compensation" means that term as defined under section 107 plus all payroll tax and worker's compensation costs.

(ii) "Staffing company" means a taxpayer whose business activities are included in industry group 736 under the standard industrial classification code as compiled by the United States department of labor.

Thus, a staffing company may deduct compensation paid to personnel supplied to its clients. But payments to a staffing company by a client do not constitute "purchases from other firms."

**Are capital gains that are included in the Modified Gross Receipts tax base also included in the Business Income tax base?**

Yes, the Business Income tax base is a separate and distinct tax base from the Modified Gross Receipts tax base. A taxpayer's Business Income tax base is its business income subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is defined in part as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, . . . , made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, . . . ." MCL 208.1105(1).

MCL 208.1201 of the MBT makes no provision for the adjustment of capital gains that may be included in federal taxable income derived from business activity. As a result, to the extent the capital gain is derived from the business activity of the taxpayer it must also be included in the business income tax base.

## Credits

**Does the Michigan Business Tax Act contain a Renaissance Zone Credit?**

The Michigan Business Tax Act (MBTA), at section 208.1433, provides a Renaissance Zone Credit that is equivalent to the Renaissance Zone Credit found in the Single Business Tax Act



# Michigan Business Tax Frequently Asked Questions

(SBTA) at section 208.39b. A taxpayer that is a business located and conducting business activity within a Renaissance Zone may claim the credit against the Michigan Business Tax (MBT) for the tax year. The credit allowed continues through the tax year in which the Renaissance Zone designation expires and is not refundable.

To obtain the credit an otherwise qualified taxpayer must file an MBT annual return. The credit is equal to the lesser of the following:

- a. The tax liability attributable to business activity conducted within a Renaissance Zone in the tax year.
- b. Ten percent (10%) of adjusted services performed in a designated Renaissance Zone.
- c. For a taxpayer located and conducting business activity in a Renaissance Zone before December 31, 2002, the product of the following:
  - i. The Single Business Tax (SBT) Renaissance Zone Credit claimed for the tax year ending in 2007.
  - ii. The ratio of the taxpayer's payroll in this state in the tax year divided by the taxpayer's payroll in this state in its SBT tax year ending in 2007.
  - iii. The ratio of the taxpayer's Renaissance Zone Business Activity Factor for the tax year divided by the taxpayer's Renaissance Zone Business Activity Factor for its SBT tax year ending in 2007.

The MBTA definitions of terms such as "adjusted services performed in a designated Renaissance Zone" and "Renaissance Zone Business Activity Factor" are repeated from the SBTA.

## **How does a Professional Employer Organization, as defined by MCL 208.1113(4), determine compensation for the small business credit disqualifier in accordance with MCL 208.1417(8)?**

Under MCL 208.1417 an entity is disqualified from taking the small business credit if more than \$180,000 is paid to an officer, director, shareholder or other defined person. A PEO is disqualified based on amounts paid to its own officers and employees. Individuals leased to a PEO's client are not considered for calculating the PEO's disqualifiers.

## **How are the adjusted business income and compensation disqualifiers of the small business credit, found in MCL 208.1417, computed for PEOs and their clients?**

MCL 208.1417(8) requires a client of a PEO to include compensation paid to the client's officers and employees leased to the client.

For the adjusted business income disqualifier, this means that the client adds compensation and director's fees paid for active shareholders and officers to business income as outlined in MCL 208.1417(9). If the client's adjusted business income exceeds \$1.3 million, the client is disqualified from taking the small business credit under MCL 208.1417(1).

Likewise, for the compensation disqualifier, the client will consider all compensation, director's fees and distributive shares paid to its officers, owners and shareholders, even though leased from a PEO. Under MCL 208.1417(1)(a) and (b), the client will be disqualified from taking the small business credit if more than \$180,000 in compensation is allocated or paid to these individuals.

While MCL 208.1417(8) directs clients of PEOs to consider all compensation of officers and employees; officers/shareholders/owners compensation and distributive shares are included for purposes of the disqualifiers.

# Michigan Business Tax Frequently Asked Questions

Active Shareholder is defined in MCL 208.1417(9)(a) as receiving at least \$10,000 in compensation, director's fees or dividends and owning at least 5% of outstanding stock or other ownership interest.

## **Is a Professional Employer Organization, as defined by MCL 208.1113(4), entitled to the Compensation Credit of MCL 208.1403?**

Yes, a PEO can take the credit for compensation that was paid to its own officers and employees, that is those individuals that actually operate the PEO entity.

However, MCL 208.1403(2) states that a PEO "shall not include payments by the professional employer organization to the officers and employees of a client ..." This means that a PEO cannot take the credit for compensation paid to officers of the operating entity nor for compensation paid to the employees leased by the PEO to the operating entity/client.

Thus, both a PEO and the operating entity it manages will take the credit to the extent permitted.

## **How is the alternate credit under MCL 208.1417 used by a unitary business group? How do the disqualifiers and percentage reducers work?**

The alternate credit (similar to SBT credit commonly known as the small business credit) "is available to any *taxpayer* with gross receipts that do not exceed \$20,000,000.00 and with adjusted business income minus the loss adjustment that does not exceed \$1,300,000.00 as adjusted annually for inflation using the Detroit consumer price index" and subject to certain additional disqualifiers. MCL 208.1417(1) (emphasis added).

"Taxpayer" is defined as "a person or a unitary business group." MCL 208.1117(5). The gross receipts and adjusted business income thresholds under MCL 208.1417(1) apply to taxpayers. Thus, for a unitary business group, the gross receipts and adjusted business income thresholds must be calculated by the unitary business group by combining the gross receipts and adjusted business incomes of its members.

The disqualifiers under MCL 208.1417(1)(a) and (b) apply to a taxpayer that is a unitary business group if such disqualifiers apply to any member of that unitary business group. For example, a taxpayer that is a unitary business group is disqualified from taking the alternate credit under MCL 208.1417 if that unitary business group includes a member that is a partnership and any one partner of that partnership receives more than \$180,000.00 as a distributive share of the adjusted business income minus loss adjustment of the partnership.

Similarly, the reduction percentages under MCL 208.1417(1)(c) apply to a taxpayer that is a unitary business group if such reduction percentages apply to any member of that unitary business group. For example, the alternate credit of a taxpayer is reduced by 20% if the taxpayer is a unitary business group that includes a member that is a corporation and the compensation and directors' fees of an officer of that member corporation exceed \$160,000.00 but are less than \$165,000.00.

## **Will Single Business Tax (SBT) credit carry forwards carry over to the Michigan Business Tax (MBT)?**

Yes, with the exception of the Historical Preservation Credit and the Brownfield Credit, any unused SBT credit carry forward can be applied to MBT tax years 2008 and 2009. Any unused SBT carry forward remaining after 2009 is lost. MCL 208.1401. This carry forward provision applies to any unused SBT credit even if the SBT credit was not retained under the MBT and is subject to credit ordering.

# Michigan Business Tax Frequently Asked Questions

The Historic Preservation Credit and Brownfield Credit carry forwards from the SBT may be claimed against the MBT for the remaining years the carry forward would have been available under the SBTA. MCL 208.1435(8) and 208.1437(18).

## **What is the compensation credit?**

MCL 208.1403 provides a credit in the amount of .370% of a taxpayer's compensation in Michigan, not to exceed 65% of the taxpayer's liability imposed under the MBT.

"Compensation" is defined as all wages, salaries, fees, bonuses, commissions, other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayers, and any earnings that are net earnings from self-employment as defined under section 1402 of the internal revenue code of the taxpayer or a partner or limited liability company member of the taxpayer. (Additional information is provided in MCL 208.1107(2)).

## **Do Historic Rehabilitation and Brownfield credits, approved under the Single Business Tax Act, carryover and can they be used against Michigan Business Tax liability?**

Yes. MCL 208.1435(8) and MCL 208.1437(18) provide that Historic Rehabilitation and Brownfield credits, respectively, issued under the SBTA and unused at the end of the last tax year under the SBTA "may be claimed against the tax imposed under [the MBTA] for the years the carryforward would have been available under [the SBTA]."

The SBTA provided a carryforward period of 10 years for each of these credits. Thus, a taxpayer or assignee with unused Historic Rehabilitation or Brownfield credit carryforwards at the close of the SBT may use and carryforward any unused portion of these credits for an uninterrupted period of 10 years.

The MBT also provides a 10 year carryforward period for Historic Rehabilitation and Brownfield credits approved in MBT years.

## **How are existing SBT credits, or those awarded but not yet certified, handled under the MBT?**

An unused carryforward from an SBT credit may be applied against the MBT liability for the 2008 and 2009 tax years only, unless specified separately. For the Michigan Historic Preservation and Brownfield Credits, an unused carryforward can be claimed against the tax imposed under the MBT for the same years the carryforward would have been available under the SBT.

For Brownfield credit purposes, the MBT allows a taxpayer that received a preapproval letter prior to January 1, 2008 under the SBTA to receive a certificate of completion and claim a credit against the tax imposed by the MBTA, provided that all other requirements are met. See MCL 208.1437. A similar provision for the Historic Preservation Credit allows a qualified taxpayer that has a rehabilitation plan certified before January 1, 2008 under the SBTA for the rehabilitation of an historic resource for which a certification of completed rehabilitation has been issued after 2007 to claim a credit against the tax imposed by the MBT. See MCL 208.1435.

Because the MBT provides for historic and brownfield credits for projects initiated prior to January 1, 2008, Public Act 240 of 2006 does not apply. PA 240 provided that a brownfield or historic rehabilitation project approved before 2007 and completed after that year could be claimed as a credit on an amended 2007 SBT return unless the credits may be claimed "for a tax year that begins after December 31, 2007 under any other tax act."

## **Who is considered an officer for purposes of the Small Business Alternative Credit under MCL 208.1417?**

The Small Business Alternative Credit (similar to the SBT credit commonly known as the small business credit) is generally available to taxpayers with gross receipts that do not exceed \$20,000,000.00 and an adjusted business income minus loss adjustment that does not exceed

# Michigan Business Tax Frequently Asked Questions

\$1,300,000.00 – adjusted annually for inflation – subject to certain additional disqualifiers. MCL 208.1417(1).

One such disqualifier states that "a corporation other than a subchapter S corporation is disqualified if . . . compensation and directors' fees of a shareholder or officer exceed \$180,000.00." MCL 208.1417(1)(b). If the compensation and directors' fees of an officer of a corporation exceed \$160,000 but are less than or equal to \$180,000, then the taxpayer is not disqualified but must reduce the credit by a specified percentage.

Under the MBT, "officer" means "an officer of a corporation other than a subchapter S corporation, including all of the following: (a) [t]he chairperson of the board[:]; (b) [t]he president, vice president, secretary, or treasurer of the corporation or board[:]; or (c) [p]ersons performing similar duties to persons described in subdivisions (a) and (b)." MCL 208.1111(5). "Corporation" means "a taxpayer that is required or has elected to file as a corporation under the internal revenue code." MCL 208.1107(3).

In other words, corporations and entities – such as limited liability companies – that elect to be taxed as corporations for federal tax purposes have officers under the MBT. "Officers" include the chairperson of the board; the president, vice president, secretary, and treasurer of the corporation or board; and any employee, member, manager, partner, or other person performing duties similar to those of chairpersons, presidents, vice presidents, secretaries, and treasurers.

## **Is the farmland preservation credit available under the Michigan Business Tax?**

No. The farmland preservation credit is found in the Natural Resources and Environmental Protection Act, 1994 PA 451. This is a stand-alone statute apart from both the Single Business Tax and the Michigan Business Tax. The public act was written to provide the farmland preservation credit (for qualifying taxpayers) against the SBT and the individual income tax. MCL 324.36109. The calculation of the credit is performed in reference to the SBT and the statute does not provide a similar credit for the MBT. MCL 324.36109(2).

## **Will the recapture limiting language of MCL 208.1403(3)(d)-(f) apply to both the Michigan Business Tax Investment Tax Credit (ITC) and ITC taken under the former Single Business Tax?**

Yes, under MCL 208.1403(3)(d)-(f) ITC recapture is limited to the extent ITC was taken when the cost for the original asset acquisition was paid or accrued and at the rate at which the credit was used under the former SBTA or the MBTA. The recapture applies to depreciable assets acquired before and after December 31, 2007. In other words, a person must recapture ITC upon disposition of assets acquired under both the MBT and the SBT subject to the recapture limitations of MCL 208.1403(3)(d)-(f) that apply to both the SBTA and the MBTA.

## **MCL 208.38g(34) and 208.39c(16) of the SBT permit taxpayers with pre-approval letters issued – or rehabilitation plans certified – prior to 2007 for projects completed after the taxpayer's last tax year under the SBT but prior to 2010 to claim a certain portion of the credit amount that would have been available in 2008 and 2009 had the SBT not been repealed on the taxpayer's amended 2007 SBT return. Are these provisions superseded by the MBT?**

Yes. MCL 208.38g(34) and 208.39c(16) of the SBT also state that the provisions allowing 2008 and 2009 credits to be claimed on the taxpayer's amended 2007 SBT return *do not apply* if credits for tax years beginning after December 31, 2007, for the same project are provided for under a new tax act. MCL 208.38g(34)(f) and 208.39c(16)(e). Under the MBT, a taxpayer with a certified rehabilitation plan or pre-approval letter is expressly authorized to claim a credit for the corresponding brownfield project or rehabilitation plan for tax years beginning after December 31, 2007. MCL 208.1435 and 208.1437. Thus, the MBT supersedes MCL 208.38g(34) and 208.39c(16).

# Michigan Business Tax Frequently Asked Questions

## Misc.

**Revenue Administrative Bulletin 2001-2 describes provisions of the SBT related to the tax base of a foreign person for tax years beginning in or after 2000. Does RAB 2001-2 apply to the MBT?**

Bulletins issued to provide guidance under the SBT are not necessarily applicable to the MBT. Furthermore, RAB 2001-2 generally addresses provisions of the SBT specific to foreign persons. Other than the definition of unitary business group under MCL 208.1117, which is limited to U.S. persons, the MBT does not distinguish between foreign and U.S. persons.

**How are Professional Employer Organizations and Staffing Companies defined for the MBT and how do the two differ?**

Under MCL 208.1113(4) a PEO is defined as an entity that manages and provides human resource assistance for another entity under contract. The PEO must retain "substantial employer rights and responsibilities," as well as several common law rights, as listed in MCL 208.1113(4)(a)-(d), that demonstrate the control of the PEO over the managed entity.

A staffing company is defined under MCL 208.1113(6)(d)(ii) as an entity whose "business activities are included in industry group 736" of the Federal Department of Labor Industrial Classification Code. This industry group represents "establishments primarily engaged in providing employment services."

MCL 208.1113(5) states specifically that a PEO is not a staffing company.

The main business purpose of a PEO, generally, is to provide a client with human resource and human resource management services. PEOs are also typically responsible for payroll, withholding and remitting employment taxes and benefits management for clients. These PEO/client relationships often involve shared control or co-employer agreements. However, as the MBT recognizes, the PEO must maintain the ultimate control in the relationship to be treated as a PEO under the tax.

In contrast, staffing companies generally supply temporary employees to supplement a customer's workforce. Staffing companies have nearly complete control of these employees. In the staffing company situation, the recipient of employees generally has no more control over the employee than direction of daily tasks or rejection of the proffered individual.

**Is sales tax collected by a retail business considered part of its modified gross receipts under the Michigan Business Tax?**

Yes. The seller of tangible personal property is the person legally liable for payment of sales tax. A seller that is reimbursed sales tax by the purchaser of tangible personal property must include in its gross receipts the "entire amount received" from "any activity" unless the amount received is statutorily exempted under MCL 208.1111. Therefore, a taxpayer that receives sales tax from a purchaser as part of a transaction not otherwise exempt under the Michigan Business Tax must include in gross receipts the amount received from the sale of tangible personal property as well as the sales tax received.

**How is the modified gross receipts tax base calculated for professional employment organizations and staffing companies? What is the significance of these different treatments?**

MCL 208.1203(3) provides the general rule that the modified gross receipts tax base equals a taxpayer's gross receipts minus purchases from other firms.

# Michigan Business Tax Frequently Asked Questions

For a PEO, gross receipts is defined under MCL 208.1111(t) as "the entire amount received by the taxpayer from any activity" except for amounts charged by a PEO to a client under a PEO arrangement that represent "wages and salaries, benefits, worker's compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee." Thus, a PEO excludes wages and the cost of wages from gross receipts.

In contrast, a staffing company treats "compensation of personal" supplied to its customers as "purchases from other firms" when calculating its modified gross receipts tax base. Compensation is defined in MCL 208.1107(2).

## **For developers in the trade or business of selling real property, does the definition of inventory as used in "purchases from other firms" include real property?**

No. "Purchases from other firms" means:

- (a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.
- (b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.
- (c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel. [MCL 208.1113(6).]

"Inventory" means:

- (a) The stock of goods held for resale in the regular course of trade of a retail or wholesale business, including electricity or natural gas purchased for resale.
- (b) Finished goods, goods in process, and raw materials of a manufacturing business purchased from another person. [MCL 208.1111(4).]

Neither "stock of goods" nor "finished goods, goods in process, and raw materials" include real property. Furthermore, developers do not generally constitute a "retail or wholesale business" or a "manufacturing business."

## **Are limited liability companies subject to the MBT?**

Yes. Under the MBT, taxpayer means "a person or a unitary business group liable for a tax, interest, or penalty." MCL 208.1117(5). "Person" means "an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, *limited liability company*, receiver, estate, trust, or any other group or combination of groups acting as a unit." MCL 208.1113(3) (emphasis added). Thus, a limited liability company is a taxpayer subject to the MBT.

## **What is the meaning of the acronym FIRE which appears in the presentation entitled MBT Overview – August 1, 2007 on the Michigan Business Tax Website?**

The acronym FIRE, at Slide 12 of the presentation, stands for Financial Sector, Insurance Sector and Real Estate Sector. The presentation, which was one of the Department's earliest overviews of the newly enacted MBT, indicated that these industries may pay more under the MBT than under the SBT.

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Insurance Companies will pay a gross direct premiums tax of 1.25% under the MBT, as addressed in Chapter 2A of the tax. Financial Institutions will pay a tax on net capital at a rate of .235%, as explained in Chapter 2B. Real Estate entities, like all taxpayers not taxed under Chapters 2A or 2B, are subject to the Business Income and Gross Direct Premiums taxes found in MCL 208.1201 and MCL 208.1203, respectively.

## **Is the deduction provided under MCL 208.1201(2)(i) altered by the MBT surcharge?**

No. The deduction provided in section 201(2)(i) functions to offset the book-to-tax difference or deferred tax liability resulting from the change from the SBT to the MBT. The credit is taken in defined percentages beginning in tax year 2015. MCL 208.1201(2)(1).

MCL 208.1201(3) states that the deduction is only available in "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. The amount of the deferred tax liability and the corresponding deduction will be calculated without reference to the surcharge, and the deduction will therefore remain the same as calculated prior to the enactment of 2007 PA 145.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

## **Does the deduction provided under MCL 208.1201(2)(i) reduce the MBT surcharge imposed under MCL 208.1281(1)?**

Yes. MCL 208.1201(3) directs that the deduction "is intended to flow through and reduce the surcharge imposed and levied under section 281." (Emphasis added). This same section explains that the deduction is calculated as the "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. MCL 208.1201(3). The surcharge is calculated against a "taxpayer's liability under [the MBT] after allocation or apportionment to this state under this act but before calculation of the various credits." The surcharge is, thus, calculated against a taxpayer's business income and gross receipt liabilities. Therefore, the deduction, which reduces the business income tax base upon which the surcharge is calculated, will flow through and reduce the surcharge.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.